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Saturday, January 21, 2006

From contracts to money

In the middle of the Darby century came the important decision of *Miller v. Race*. Surprisingly, no copy of this case is to be found online save in the syllabus of Professor Gregory Maggs. So with his permission I've appended his edited version of the case (with some additional very minor edits of my own) below.

Negotiable instruments – checks, bank notes, and so on – are promises to pay or orders with an implied promise to pay, and are thus contracts. But they differ from contracts in two important ways. First is the idea of "merger." Normally, a contract right is an abstraction that is located nowhere in particular but belongs to a party to the contract or to a person to whom that party has assigned that right. Possessing a copy of a normal contract has nothing to do with who has rights under that contract. But in a negotiable instrument, the contract right is "merged" into the document. Assignment of that right takes place simply by transferring the document (in the case of a bearer instrument) or by indorsing (signing) and transferring it.

The second big way negotiable instruments differ from contracts is the "good faith purchaser" or "holder in due course" rule which is illustrated by *Miller v. Race*. In a normal sale of goods under common law, the new owner's title to the goods is at risk to the contractual defenses of a prior owner. For example: Alice is Dr. Barb's patient and is feeling ill. Barb says to Alice, "sell me your Mercedes for $100 and you'll feel a lot better." Alice complies, but then later realizes she was snookered. Meanwhile, Barb sells the car to Chuck, who knows nothing of how Barb acquired it, for $50,000. Under contract law, Chuck can get no greater title to the car than Barb had. But the contract is void for undue influence, so Barb doesn't have legal title to the car. Ergo, Chuck does not, either. Alice can sue Chuck to get her car back. Chuck must then sue Barb for his $50,000, an expensive and often-futile thing to do.

Contract defenses are invoked so commonly that any downstream owner of a good is at significant title risk under common law. This risk could make things very bad for paper money, which to work efficiently should change hands dozens of times or more. Thus, *Miller v. Race* has long been celebrated as an advance that made bank notes under the common law a more efficient form of money. *Miller* helped create for promissory notes under common law (including, crucially, bank notes) what is now known as the "good faith purchaser" or "holder in due course" rule. Summarized, this rule says that a holder in due course who obtained the instrument for value, in good faith, and without notice of any upstream claims or defenses, is entitled to enforce the promise to pay in that instrument regardless of most kinds of such claims or defenses.

The good faith purchaser rule can cause its own problems. For example, when you sign a promissory note to get a mortgage, these days the bank usually sells that note to an aggregator, who bundle up these mortgage notes in packages and sell them to investors. In most states if you make your mortgage payments to Bank A, who has meanwhile sold the mortgage to Bank B (and perhaps not told you),

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Bank B can bill you for that same payment and foreclose on your house if you don't pay. You have to pay Bank B and then beg, plead, or sue Bank A to get your money back.

Today, the differences between negotiable instrument law and contract law are sufficient that negotiable instruments and sale of goods are in different and largely distinct sections of the U.S. Uniform Commercial Code.

Mr. Race was a clerk at the Bank of England who refused to pay on demand when Miller presented the Bank's note. Miller was an innkeeper who had unknowingly taken the note as payment from a lodger who had stolen the note from the mails. Forthwith, *Miller v. Race*:

Miller v. Race
Court of King's Bench
1 Burr. 452, 97 Eng. Rep. 398 (K.B. 1758)

> It was an action of trover against the defendant, upon a bank note, for the payment of twenty-one pounds ten shillings to one William Finney or bearer, on demand.
>
> The cause came on to be tried before Lord Mansfield at the sittings in Trinity term last at Guildhall, London and upon the trial it appeared that William Finney, being possessed of this bank note on the 11th of December 1756, sent it by the general post, under cover, directed to one Bernard Odenharty, at Chipping Norton in Oxfordshire; that on the same night the mail was robbed, and the bank note in question (amongst other notes) taken and carried away by the robber; that this bank note, on the 12th of the same December, came into the hands and possession of the plaintiff, for a full and valuable consideration, and in the usual course and way of his business, and without any notice or knowledge of this bank note being taken out of the mail.
>
> It was admitted and agreed, that, in the common and known course of trade, bank notes are paid by and received of the holder or possessor of them, as cash; and that in the usual way of negotiating bank notes, they pass from one person to another as cash, by delivery only and without any further inquiry or evidence of title, than what arises from the possession. It appeared that Mr. Finney, having notice of this robbery, on the 13th December, applied to the Bank of England, "to stop the payment of this note:" which was ordered accordingly, upon Mr. Finney's entering into proper security "to indemnify the bank."
>
> Some little time after this, the plaintiff applied to the bank for the payment of this note; and for that purpose delivered the note to the defendant, who is a clerk in the bank: but the defendant refused either to pay the note, or to re-deliver it to the plaintiff. Upon which this action was brought against the defendant.
>
> The jury found a verdict for the plaintiff, and the sum of 21l. 10s. damages, subject nevertheless to the opinion of this Court upon this question—"Whether under the circumstances of this case, the plaintiff had a sufficient property in this bank note, to entitle him to recover in the present action?"
> * * *
>
> Sir Richard Lloyd, for the defendant.
> The present action is brought, not for the money due upon the note; but for the note itself, the paper, the evidence of the debt. So that the right to the money is not the present question: the note is only an evidence of the money's being due to him as bearer.

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The note must either come to the plaintiff by assignment; or must be considered as if the bank gave a fresh, separate, and distinct note to each bearer. Now the plaintiff can have no right by the assignment of a robber. And the bank cannot be considered as giving a new note to each bearer: though each bearer may be considered as having obtained from the bank a new promise.

I do not say whether the bank can, or cannot stop payment; that is another question. But the note is only an instrument of recovery. Now this note, or these goods (as I may call it,) was the property of Mr. Finney, who paid in the money: he is the real owner. It is like a medal which might entitle a man to payment of money, or to any other advantage. And it is by Mr. Finney's authority and request that Mr. Race detained it.

It may be objected, that this note is to be considered as cash "in the usual course of trade." But still, the course of trade is not at all affected by the present question, about the right to the note. A different species of action must be brought for the note, from what must be brought against the bank for the money. And this man has elected to bring trover for the note itself, as owner of the note; and not to bring his action against the bank for the money. In which action of trover, property can not be proved in the plaintiff: for a special proprietor can have no right against the true owner.
* * *

Mr. Williams contra for the plaintiff.
The holder of this bank note, upon a valuable consideration has a right to it, even against the true owner.

1st, the circulation of these notes vests a property in the holder, who comes to the possession of it, upon a valuable consideration.

2dly, this is of vast consequence to trade and commerce; and they would be greatly incommoded if it were otherwise.

3dly, this falls within the reason of a sale in market-overt; and ought to be determined upon the same principle.
* * *

Lord Mansfield now delivered the resolution of the Court.

After stating the case at large, he declared that at the trial, he had no sort of doubt, but this action was well brought, and would lie against the defendant in the present case; upon the general course of business, and from the consequences to trade and commerce: which would be much incommoded by a contrary determination.

It has been very ingeniously argued by Sir Richard Lloyd for the defendant. But the whole fallacy of the argument turns upon comparing bank notes to what they do not resemble, and what they ought not to be compared to, viz. to goods, or to securities, or documents for debts.

Now they are not goods, not securities, nor documents for debts, nor are so esteemed: but are treated as money, as cash, in the ordinary course and transaction of business, by the general consent of mankind; which gives them the credit and currency of money, to all intents and purposes. They are as much money, as guineas themselves are; or any other current coin, that is used in common payments, as money or cash.
* * *

Here, an inn-keeper took it, bonâ fide, in his business from a person who made an appearance of a gentleman. Here is no pretence or suspicion of collusion with the robber: for this matter was strictly inquired and examined into at the trial;

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and is so stated in the case, “that he took it for a full and valuable consideration, in the usual course of business.” Indeed if there had been any collusion, or any circumstances of unfair dealing; the case had been much otherwise. If it had been a note for 1000l. it might have been suspicious: but this was a small note for 21l. 10s. only: and money given in exchange for it.

* * *

A bank-note is constantly and universally, both at home and abroad, treated as money, as cash; and paid and received, as cash; and it is necessary, for the purposes of commerce, that their currency should be established and secured.

* * *

Lord Mansfield declared that the Court were all of the same opinion, for the plaintiff; and that Mr. Just. Wilmot concurred.

Posted by Nick Szabo at 11:35 AM

3 comments:

David Hillary said...

So ... bank notes are negotiable instruments capable of being received with better title than the person from whom they were obtained. All very good. Does coin enjoy the same, or a similar, status, regards to security of title of the bearer? The comments in the blog indicate so, but do not really say it explicly

4:17 AM

frankxq said...

In 1758, coins already had the status of passing in currency - they had long been treated as fungible (one coin may pass as another). Confirmed by Lord Mansfield thus - "They [notes] are as much money, as guineas themselves are; or any other current coin, that is used in common payments, as money or cash."

7:03 AM

Anonymous said...

> But the contract is void for undue influence

I may be a few years too late, but this is wrong: undue influence makes a contract voidable, not void. The difference is crucial here: if the contract was is only voidable, and isn't voided before the resale, then s.23 SOGA applies and the buyer can get good title.

2:13 PM

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